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Dec. 27, 1989 LETTER 1033

FUNDAMENTALS: Honest, the fundamentals don't look too great. The US auto industry appears to be falling apart (and not just on a cyclical basis). Once-mighty GM has been losing market share for years, and it now has only 35% of the US market (down from 46% 10 years ago). Two weeks ago Chrysler's debt was downgraded by Moody's to BAA2 from BAA1 (that's well below investment grade). Auto plants are closing en masse, burdened by the highest inventory of US cars in history (an 83-day supply). Last week, at a meeting of Ford executives, it was announced, "By the early 1990s we expect excess automotive capacity to reach 8.4 million units worldwide. Coupled with an expected slowdown in economic growth, this excess capacity will escalate global competition from a fight for market share into a battle for survival."

So much for autos. How about retailing? Well, Campeau Corp. states that its giant Allied and Federated divisions might have to file for bankruptcy in January (yes, that includes Bloomingdale's). Christmas this year has become an endless parade of sales and discounts. Housing? Home prices are weakening across the nation (yes, even in California), while commercial real estate (amid high vacancy rates) has become another huge problem for the banks. The latest candidate for a regional disaster appears to be New England, with horror stories now abounding in this area.

From Washington, Mr. Bush states that the multi-billions of dollars that the government has put up to bail out the S&L industry "might not be enough." The electronics and computer business has turned viciously competitive with once-sacrosanct IBM sinking to new 52-week lows. The Dec. 14 *WSJ* tells us that "Brand name computers from IBM to Apple, the two biggest makers, are priced 30% to 45% off list price."

So we have recession in autos, in much of housing, electronics, computers, in the Northeast and Southwest, and certainly on Wall Street itself. But still, almost to a man, our leading economists say, "No recession."

So the arguments go, but remember this -- the markets aren't interested in yesterday's news, and they're just as disinterested in today's news. The markets march to the drums of tomorrow. With that thought in mind let's examine what's happening on Wall Street.

THE MARKETS: For months I've been warning about technical deterioration in the markets. Now some of that (previously hidden) weakness is beginning to break out into the open -- in the form of lower prices on Wall Street. It's almost comical the way the newspapers and commentators attempt to explain each day's decline in terms of some specific current event. But we know that distribution in the market has been going on for many months. In view of that let's review some of the events that have transpired.

On September 5 the D-J Transportation Average recorded its all-time high of 1532.01. That high has not been surpassed. I've been saying that the Transports "are through," that the carriers have "topped out for the duration." If that's true, then by definition the bull market is over (and personally, I do think the bull market is over). On November 2 the Transports broke to a low of 1158.25. Subsequently, they rallied listlessly. On December 18 the Transports broke to another new low. As of this writing the carriers are roughly 400 points below their record September 5 high!

Dec. 15 DJIA 2739.55; PTI 3300; A-D Ratio -7.60
Dec. 21 DJIA 2691.13; PTI 3290; A-D Ratio -8.15
Dow Yield: 3.90%; Dow P/E: 11.7; DowPow: 578
Dow Book Value: 1075; Dow 200-day MA: 2568
Percentage of Undervalued Blue-chips: 16%
PTI 89-day Moving Average: 3255

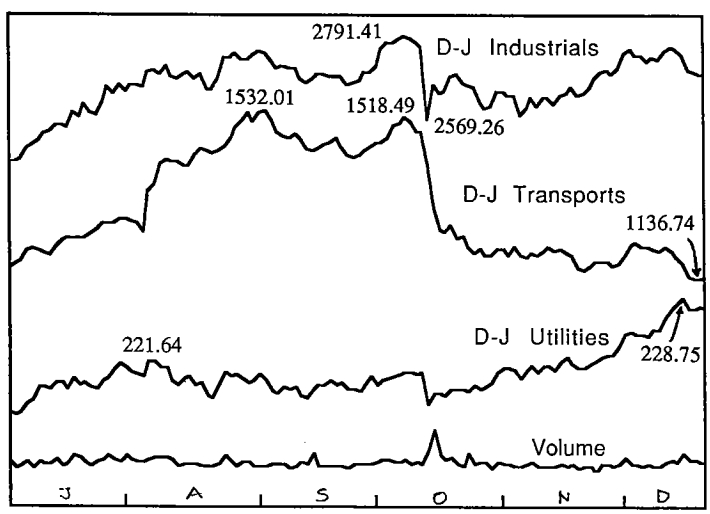
On October 9 the D-J Industrial Average closed at a record high of 2791.41. However, the Transports failed by a huge margin of over 300 points to confirm. The Dow then dropped to an October 13 low of 2569.26 -- before rallying back to above 2700. **The October low of 2569.26 is now a critical point.** A breaking of that level would confirm Transport weakness, and, in my opinion, would confirm that a primary bear market is in progress.

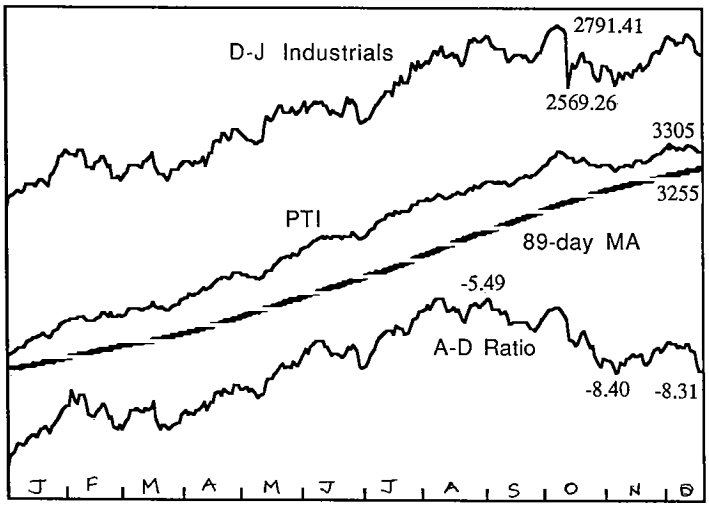
The advance-decline ratio has been lagging badly and acting poorly ever since its August 5 peak of minus 5.49 (see page 2 chart). The A-D broke to a low of minus 8.40 on November 6, then laboriously rallied. As this is written, the A-D ratio is within easy shooting distance of its November 6 low. The A-D is a proxy for ALL the stocks on the NYSE. A breaking of the November low would have very bearish implications.

In Letter 1031 I included the Lowry Buying Power/Selling Pressure studies, and I showed that systematic selling started coming into this market as far back as June. On November 3, Lowry's Selling Power line moved above the Buying Power line, thereby rendering a bear signal. The Lowry studies are now in the bear mode with Selling Pressure clearly dominating the picture.

I've noted that daily new lows on the NYSE have been increasing and are now excessive, a situation characteristic of market tops. On December 19 daily new lows surged to 141, the highest since last July. On the NYSE new lows are now surpassing new highs on a daily basis, a bearish condition. I've also noted that by Joe Granville's latest careful count, over 500 NYSE issues are within one point or less of recording new 52-week lows. This, of course, points to tremendous internal weakness in the market.

Letter 1031 included charts showing the relentless breakdowns in the advance-decline lines on both the AMEX and the NASDAQ. On





December 18 the very broad Value Line Composite tumbled to its lowest level since last April. On the same day the NYSE Financial Index (which includes ALL financial issues such as banks, S&Ls, brokers, small loans) broke to its lowest level since May 25.

On December 15 the Summation Index (see last Letter) which is based on advance-decline statistics gave a sell signal. This was followed on December 18 by a 42-point drop in the Dow and over 1200 declines on the NYSE.

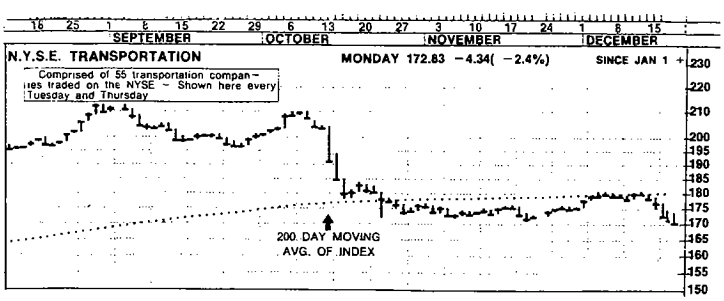
All right, how about my Primary Trend Index (PTI)? The PTI recorded a high of 3289 on October 10. It sank to a low of 3247 on November 6, then climbed to a new high of 3305 on December 4. As of this writing the PTI is at 3290 -- almost the same level it was two months ago. Thus the PTI has been losing momentum, but it has not yet issued a bear signal A bear signal will come if the PTI drops below its 89-day moving average. The moving average now stands at 3255 (see page 2 chart).

Question: What about the recent record highs in the Utility Average? Isn't that bullish?

Answer: Although the Utility Average in the past has often acted as a bellwether, a leader for the market, I view the recent strength differently. I believe the new high in the Utility Average represents a "flight to quality," much as the current move into T-bills and T-bonds represents a flight to safety. Therefore, I don't view the new Utility highs as a bullish phenomenon. Furthermore, if this is a primary bear market, my guess would be that the utilities will come under severe pressure in due time -- as the bear market progresses.

Question: Russell, you've placed a lot of emphasis on the breakdown in the D-J Transportation Average. But the Transports were bulled by a few takeover airline stocks -- and now those stocks are declining. Therefore, haven't those few airline issues given a deceptive appearance to the D-J Transportation Average?

Answer: Not as much as you might think. The Transportation Average reflects the sales and shipping capacity of the nation. *Investor's Daily* runs a transportation average of their own, an average which tracks a very broad selection -- **55** transportation stocks. Here's their chart. This index is breaking down too. No, the transport issues are telling a story, and the story is a bearish one. And I don't care what transportation average or index you are looking at.



A BIT OF PHILOSOPHY: Nobody can beat the markets in all areas (at least I've never met anybody who could). Speaking for myself, I've had to make hard decisions as to what to do and where to put my money.

Here are some thoughts put together after 45 years of watching and dealing with markets. The ideal place to invest is in a newly-confirmed bull market. In other words, I don't care what the item is, but I do care where any given item is in terms of its bull and bear cycle. Let me put it another way, "Don't tell me what to buy -- tell me WHEN to buy it."

I don't like to operate outside my sphere of knowledge. For instance, I'm not familiar with the emerald market so I don't speculate or invest in emeralds. And I don't know the recycled paper market so I don't speculate or invest in recycled newsprint. In other words, I only invest in markets that I understand.

Next, I like liquid markets, markets where you can get in and out in quantity -- and in a hurry. Therefore, even if I did understand the emerald or the recycled newsprint markets, I would never invest in them.

Finally, you can't make money if you haven't got faith enough to take a BIG position. Therefore, I have to believe that the item I am investing in represents VALUE. If it isn't a value, I personally can't (or won't) move into it in a major way. So above all, I must buy values (be it gold under 400, stocks at attractive yields, or bonds that offer fat returns). Barring values, I'd rather stay in cash.

Back during the early '80s I liked stocks as values. I thought a great many stocks were bargains in 1982, and I said so. In 1984, I thought bonds were bargains, and I said so. Personally, I had almost all my assets in bonds during 1984 to 1989. I exited the bond market with six figure profits in mid-1989. I'm not a piggy. I was satisfied, I had enough. I took the profits, and with part of those profits I'm now adding two new rooms to my house. So much for 1982 to '89.

I left the bond market for two reasons. One was that I thought bond yields were becoming unattractive compared to the much safer yields on short-term credit instruments. The second reason was that everybody and his brother were predicting lower interest rates and higher bond prices. That may well happen, but so far bonds have not rallied to new highs. When the market doesn't do what everybody says it's supposed to do -- that worries me. I worry about a market that doesn't perform as advertised.

So I rested with most of my money in short-term credit instruments. But I did do one thing (and I suggested that my subscribers do the same). I bought a fixed amount of gold coins at the beginning of each month. What I wanted to do was build up a gold position at an average price of gold which was below 400. And that's what I did.

Then when gold broke out above 400, and when gold broke above its critical 65-week moving average. I continued my buying and I also moved into no-load gold funds. My thinking was that a new bull market in gold had been born. The best investment opportunities appear in new bull markets, and the only NEW bull market that I can identify is the one in gold.

If I'm correct, if this is a new bull market in gold, then we are now in the first phase of that bull market. The first phase is almost always a difficult one. The public is skeptical during the first phase. And the price action is almost always erratic. There are stops and starts, run-ups and swoons -- and always -- the rumors.

Furthermore, in the first phase, there are a lot of conflicting opinions, and the item (be it gold stocks, bonds, or anything else) is very sensitive to any comment or news. "You say Gorby might resign?" "You say the Japanese are buying gold?" "You say Washington is selling gold?" "You say the new European currency

will be gold-backed?" "You say the Ruskies will issue gold-backed bonds?" "Wow, ugh, hey, great, awful, buy, sell." The real reasons for the moves are seldom understood during the first phase of a bull market, so the item is extremely sensitive to those ever-present rumors.

Back to the stock market. I've been out of the stock market for a while. My main interest in the stock market at this point is for its barometric properties. If we are going into a recession or worse, the market will discount it. Therefore, I want to see whether the D-J Averages break below critical low points.

The Transports have already broken below their critical November low of 1158.25. Now I want to see whether the Industrials confirm by violating their October low of **2569.26** (see page 1 chart). If those lows are broken I believe the Averages will be saying primary bear market and "recession."

The NASDAQ Index has already broken down badly. This Index is now at a five-month low. The AMEX Index is about to break below its critical October low.

Progression change: There is much confusion about the continuing strength in the Japanese market. In "the old days," the normal progression at bull market tops was for the weak market, the British market, to top out before the strong market, which was the US market. By the same token at bear market bottoms, the weaker British market would bottom out after the stronger US market. But times have changed.

Today Tokyo has superseded the US as the strong market, and Britain and US are the weaker markets. So what's happening today? Both the US and British stock markets topped out in September while Tokyo is still near its highs. As the bear takes hold in earnest both here and in Britain, it will only be a matter of time before Tokyo follows -- to the downside.

INVESTMENT POSITION: I'm getting tired of writing the same thing, and I would guess my subscribers are getting tired of hearing the same thing. But I'll repeat it -- I like liquidity here, and that means money market funds, muni money market funds, T-bills, two-year T-notes, strong currencies such as the Deutsche mark, gold, gold shares, and gold coins.

I've stated that this is my own position. It's what I've done. What else can I say? As far as the market is concerned, I think it's a bear market, but I can't prove it yet. Let the Dow break below 2569.26 and the bear case will look very strong indeed. Let my PTI break below its moving average and the bear case will be overwhelming.

In the meantime, the case has looked bearish enough to me that I've been liquid for months. As for the market designation, I'm leaving a very shaky question mark in the box -- until either the Dow or the PTI breaks one of the above-designated points. If that happens, say hello to the official bear.

THE DOW AND SAN DIEGO HOUSING: Here's a piece of original research that you won't see anywhere else. It was done by my good friend, Jon Strebler, of Dean Witter in La Mesa, Ca. For many years Jon and I have talked about the relentless rise in the price of San Diego homes. And here's a chart (see page 4) that Jon drew which traces San Diego home prices from the 1880s to the present, along with the Dow.

When I first moved from New York City to San Diego in 1961 this town was "a navy town" with a total population of around 300,000. I would write to friends in the East about the wonders of this semi-tropical land, and they would write back and ask, "Where the devil is San Diego -- is it north or south of LA?"

Times have changed. Most of the nation now knows where San Diego is, and a large portion of the US, it seems, has decided to move here. I won't go into all the positives such as San Diego's idyllic climate, its proximity to the mountains, the ocean, the desert, etc. Suffice it to say that the population here is now over 1 million, and San Diego has just passed Detroit to become the nation's sixth largest city.

Meanwhile, it seems the price of housing, at least since 1930, has never stopped going up. Homes that sold for $250,000 a few years ago are $500,000 now. All of this makes San Diego one of the nation's least affordable cities (based on average income vs. the median price of a home).

There's a recent trend, and it's interesting. You sell your million-dollar home in San Diego (or LA or San Francisco), move up to Oregon or Washington and buy a better house for $200,000, and you just about live on the difference which you invest in income-paying securities. On top of that, you escape California's murderous taxes. You want to go the whole hog? Then move to Texas or Nevada, buy a bargain house and escape state taxes altogether. The catch -- you'll miss the climate and you may miss the California lifestyle. But as they say, everything in life is a trade-off.

Meanwhile, the Nov. 4 London *Economist* published an article which states that the California housing "boom died abruptly at the end of the first quarter because lenders suddenly grew cautious and buyers were priced out of the market." Although prices have not really sagged yet in California, sales have. They're down 15% from the seasonally adjusted first quarter rate.

On December 21 the *WSJ* headlined a rather scary piece on the housing picture, and I include a clip from that article here. Meanwhile, turn to the chart on page 4. There would seem to be a lot of room for a correction, wouldn't you say?

Shaky Structure

Home-Price Slump Spreads to Both Coasts, Causing Market Jitters

Slide After Extended Boom Isn't Viewed as Harbinger Of a General Recession

Was It Overrated Investment?

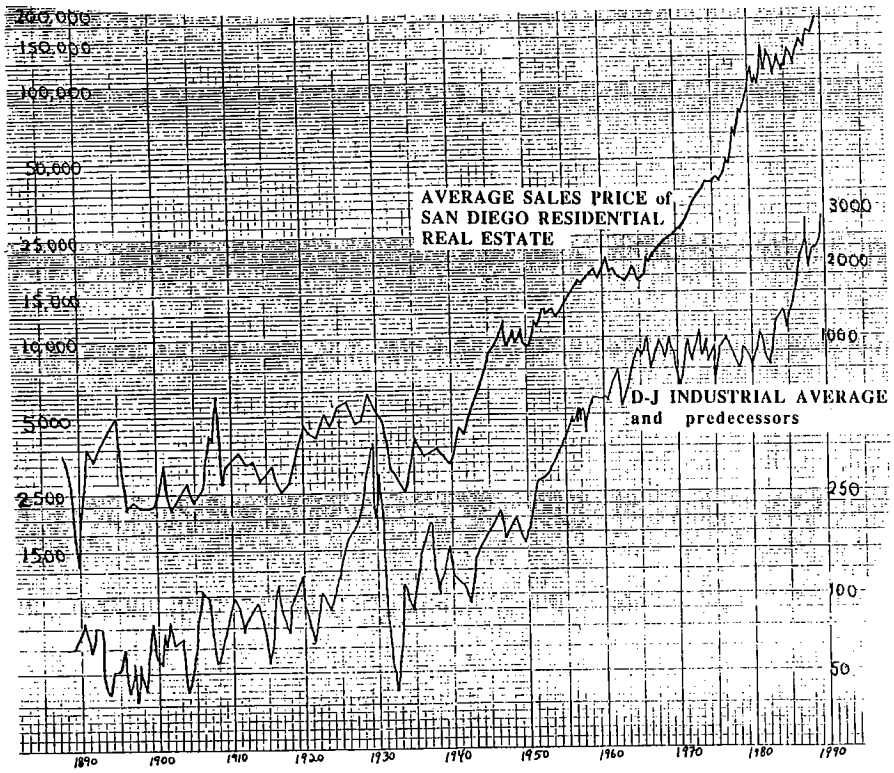
By William Celis III
Staff Reporter of The Wall Street Journal

In San Francisco, Maurice Rosofsky and his wife haven't received a single offer for their four-bedroom condominium. After listing it at $539,000 in August, they have cut the price three times. Mr. Rosofsky, a Chevron Corp. accountant moving back to Texas, says he will go as low as $475,000 but no lower.

In Chatham, N.J., home builder W. Art Wells didn't budge from the $665,000 asking price on a home he built, but he did kick in

Northeast Banks' Troubles
Three big Northeast banks announced significant additions to their loan-loss reserves because of the region's growing real estate woes. Story on page A2.

a dizzying array of giveaways to the



NOTES & QUOTES: Soviet compromises: After all the hullabaloo, the Russians are NOT moving to get the job done. During the big meeting a week ago, the Soviets decided on a new tax system, a reform of wholesale and retail prices, and an overhaul of banking "before 1996." This nitpicking approach simply isn't going to cut it. The Soviets still resist anything like a free-market system. They still basically want central planning. Furthermore, the Soviets never mentioned backing either their bonds or the ruble with gold. Russell opinion: Even Gorby doesn't want to give up major control by the Communist party nor does he want to give up central control of markets. Watch for the ongoing Soviet disaster to deepen. Major, radical reform measures are needed. But the Soviets are compromising, bowing to the conservatives, going very, very slowly with a new six-year plan. I guess in the end the Soviet higher-ups are much like US politicians. Above everything else, they want to stay in office and hold the power.

The Deal To Watch: The Soviets have 19 divisions in East Germany. And they're working on the deal of the decade. The West wants a European Federation consisting of France, Britain, Germany, Italy, Spain, Portugal, Greece, and Turkey. But this can only happen if Germany remains divided. Why? Because the Soviets will never give up East Germany without a major deal which is beneficial to the Soviets.

The deal -- the Soviets will allow a unified Germany if Germany pulls out of both NATO and the European community (whew!). If that happens the Soviets will have engineered a major triumph. The bait for Germany -- Germany will then have effective control of all the raw material and markets from the Rhine to the Urals. In other words, Gorbachev's dream-deal would be a Germany separated from the US and associated more with the Soviets than the West. It would be a unified German economic colossus that could power and rejuvenate the Soviet Union. I cannot overemphasize the importance of this whole concept -- it could define the shape of Europe for years to come. (Note: much of the foregoing comes from a brilliant piece by Joseph Harsch in the Dec. 7 *Christian Science Monitor.)*

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"Peace Dividend?" Maybe, but not too soon. Mr. Bush has just sent the Pentagon a dollar limit for its new budget. The limit is reputed to be $292 billion, only a 2% drop from last year. Congress may want much bigger cuts, but we'll see. Meanwhile, Defense Secretary Cheney has announced that he wants to go full speed ahead with the incredibly expensive B-2 bomber, building five new planes in 1991.

* *

Is America a nation of addicts? Judge for yourself. According to Joseph Califano, Jr., former Secretary of Health, Education, and Welfare, "American addiction to drugs and alcohol (legal and illegal) crowds every nook and cranny of our nation." Its economic cost is $300 billion lost to crime, health care, and lost productivity. "Addiction in America gives new meaning to the word awesome: 57 million Americans are hooked on cigarettes, 18 million are addicted to alcohol or abuse it; 21 million have tried cocaine; more than 1 million are hooked on crack; 7 million smoke marijuana at least once a week; as many as 1 million are hooked on heroine; 10 million abuse tranquilizers and other psychotherapeutic drugs like LSD and PCP. And ice -- smokable speed and a likely candidate to succeed crack as the 1990s drug of the month --has already hooked thousands." Russell comment: Law enforcement is supposed to solve this? I'd say that the only hope is education, and a way of taking the profit out of drugs. The only way I know of taking the profit out is decriminalization. This is a national health fiasco, and it's wrecking the nation.

* *

Is it OK for foreigners to buy US debt? Sure it is. And is it OK for the US to pay foreigners interest on all the US bills, notes, and bonds they own? Sure. But do you know what we paid our foreign creditors (not the ones who own our businesses, just the ones who own our treasury debt)? Last year the US paid them $27 billion or half a billion a week! From 1981 to 1988 the US paid those same foreigners $165.4 billion, and the annual amounts are rising.

* *

Japan bashing: Seen outside Rockefeller Center (a large portion of which was recently purchased by the Japanese) a woman selling T-shirts saying, "Welcome to Wokefeller Center." NYC rumor -- the huge Rockefeller Center Christmas tree is to be replaced next year by a 9-inch Bonsai tree.

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Talk about Contrary: I recently studied a listing of predictions by 50 "name" economists. Referring to next year's GNP, only one economist, my friend Gary Shilling, was predicting actual negative GNP (Gary believes we are moving into a tough recession). Two week ago Gary sent me his new board game which is called "The Deflation Game." How does it work? I'll abbreviate it by saying that the game ends when one player still has assets and all the other players are broke (no cash or assets) and are unable to borrow any more money from the bank. (The game is available by sending $27.95 to Lakeview Services, PO Box 521, Short Hills, NJ 07078.)

* *

On December 31, 1992, the new unified Europe will be born. There is an excellent chance the new Europe will have one central bank and one currency. If the US continues to compound its deficits and debts, I think we could see the time when Europe and Japan, as major creditors, will either dictate harsh, restrictive terms to us or simply refuse to accept or deal for dollars. At such time, it may well become necessary to back the dollar with gold again -- or at the least to issue gold-backed bonds. If the US government issues gold-backed bonds, it will lower the acceptability of all other US bonds (i.e., all bonds that are not gold-backed).

* *

The banks: The US commercial banks still have $60 billion in exposure in Third World debt. On top of that they have $150 billion exposure in LBO loans. But according to the London *Economist* (Dec. 9) the real worry coming up is in banks' commercial property loans. These amount to $350 billion or 370% of American banks' total equity.

But these loans could spell big trouble. Twelve major US cities are in mid-slump including Phoenix, LA, Boston, and New York. All have vacancy rates on commercial property in the 14% area (LA's

rate is 19%). This sets up the possibility that hundreds of millions of dollars in commercial properties will fail. So this is an area everyone is watching. It's the Achilles heel of the banking picture. Note: last week the Bank of New England announced that it has a whopping $1.6 billion in bad loans on the books. Is New England today turning into the Texas of a few years ago?

The S&L picture is an on-going horror story. The S&Ls showed a near-record third-quarter loss of $3.8 billion, and for the first three quarters the total loss was $11.5 billion, far ahead of last year. It also looks as if close to 1,000 "thrifts" will be closed in 1990, far more than originally predicted. But perhaps the most frightening part of the picture is the continued exit of S&L deposits. It looks as if in November deposits dropped better than $10 billion.

Our government is not doing much better. The federal budget for the single month of November was $28.96 billion. Combined with the October deficit, the total deficit for the two months was $55.05 billion. Thus the deficits for these two months is half the $100 billion budget deficit ceiling being set (by Gramm-Rudmann) for the next fiscal year!

* *

Japan is tough on lawyers. Last year 1.8% of the lawyers who took the Japanese bar passed (vs. around 50% in the US). This year 2% of the applicants passed the bar, thereby introducing a total of 512 new lawyers into Japan. The Japanese sentiment toward lawsuits is quite different from that of the US. Most Japanese feel it is a loss of face to have to sue someone. Thus the Japanese bend over backwards to avoid the courts.

* *

The price of a seat on the NYSE peaked on September 21, 1987, at which time a seat sold for $1.15 million. But since the October '87 crash seat prices have been heading down. A few weeks ago a seat sold for $425,000, lowest price in four years. What's causing the crumbling of seat prices? A cut-back in program trading, brutal competition for commissions and generally lower volume on the NYSE.

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Once again, I must tell subscribers that I can't answer all the letters and questions that arrive here daily. I just haven't got the time and energy to answer these Letters and also write Dow Theory Letters. Remember, I write six full small-type pages every two weeks, and believe it or not those six pages require a lot of thinking and planning. So forgive me, dear letter-writers, please. But I want you to know that I do read each and every letter carefully. I particularly appreciate letters with information and ideas. I feel as though I have 8,000 pairs of eyes helping me to see and understand what's going on.

* *

Don't ask me why but words for animal multitudes have always fascinated me. Here are some you English students really should memorize: a crash of rhinos, a covey of quail, a pride of lions, a plague of locusts, a kindle of kittens, a gam of whales, a leap of leopards, a pod of seals, a sloth of bears, a rafter of turkeys, a pace of asses, a skulk of foxes, a trip of goats, a husk of hares, a labor of moles, a mustering of storks, a bale of turtles, a pitying of turtledoves, a drift of hogs, a siege of herons, a gaggle of geese, a bevy of roebucks. And enough already.

* *

Talk about Glasnost: Moscow was surprised a few weeks ago by "The Exhibit of Poor Quality Goods" (sponsored by the new USSR Consumer Society). The exhibit went on Soviet TV for hours, and viewers saw split-seamed clothings, rotten food, oblong volleyballs, cross-eyed teddy bears, rusted samovars, chipped stew pots, scratchy towels, sour milk, putrid lettuce, crushed cans of fish, and the show-stopper -- a bottle of mineral water in which was floating a tiny dead mouse. Said Marina Nitchkina, a government bureaucrat in charge of quality control, "We didn't have to go to much effort. We just went around to a few stores, picked at random, and that was that." Said Alexander Klebko, an interviewed worker at the exhibit, "This isn't so bad. I've seen worse. Most stores have less than this or nothing at all."

* *

Mexico: 25 miles south of San Diego in Tijuana all is not calm. US execs are complaining that the Japanese (who are building large "maquiladora" plants) are driving up wages. Most US companies are paying $1.30 an hour, and the Japanese are flexing their muscles (and getting the best workers) by pushing rates up to $1.50 to $1.60 an hour. Minimum wage in Tijuana is $3.25 a day.

* *

From a Fargo, ND subscriber: "Japan is converting dollars into real estate and US corporations. One million dollars will buy a two bedroom home in Japan or two apartment houses in the US. World War II ain't over til it's over." Mmmm.

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Question: Why do animal-rights activists shout at people who wear furs but not at people who wear leather? Answer: It's a lot safer to shout at a woman in mink than it is to scream at a biker in black leather (and has anyone yelled at you for wearing leather shoes lately?).

* *

The Dec. 13 New York weekly, *7 Days* (I really like this magazine), has a piece entitled, "Getting Out of Manhattan." The article discussed the various escape routes out of Gotham and when to take them. I wish someone would do a similar piece for LA. When I visit my daughter in LA, I find the best time to get in or out is around 2 a.m. in the morning (and even then there's traffic). Pathetic, isn't it?

* *

The Dec. 18 *Barron's* features a piece on "The Recession in Real Estate." The declining value of real estate is one of the major dangers that the US could be faced with in coming years. The article notes that home equity represents 40% of the net worth of American families. It also notes that the total value of all US dwellings (including apartment houses) is $7 trillion. Mortgage debt of one- to four-family homes is a fat $2.3 trillion. The rise in value of houses over the last few decades represents a large part of the so-called "wealth effect" (people feel richer and spend more as inflation in home values adds to their net worth). Now, as home prices soften, we will get a "reverse-wealth effect." That's something that the boys in Washington never planned on and haven't had to deal with -- yet.

* *

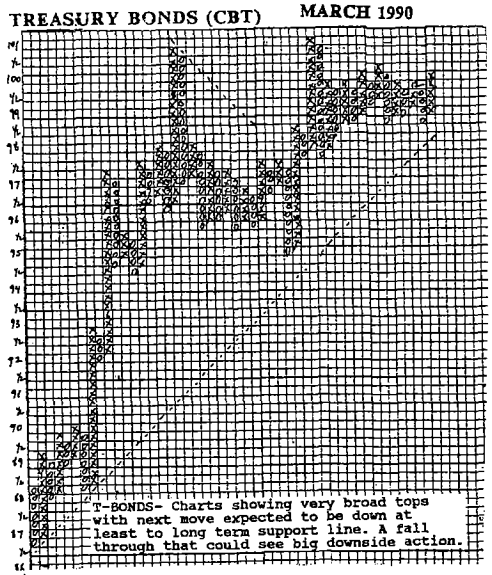
What's a good agent worth? Ask the heirs of the great Babe Ruth. In 1984 his heirs received a total of $100. Then the Curtis Management Group took over and started licensing Babe Ruth -- everything from calendars to cutlery. Royalties to the Babe's heirs last year was $800,000, and this year it will be $1 million. Said an ad man from Ogilvey & Mather Advertising Agency of the pot-bellied sports legend, if he were alive today "I can't think of a category he wouldn't fit into, except Weight Watchers."

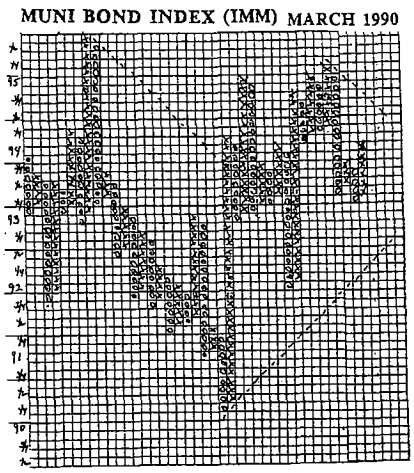
* *

MONEY: I continue to be fascinated with the bond picture. The almost unanimous forecasts and predictions have been for lower rates and a booming bond market. But it hasn't happened yet. What's up? Is the economy better than anyone thinks it is? Is the Fed worried about the dollar and therefore afraid to drop the discount rate? Is the Fed annoyed by all the advanced advertising for lower rates? Why won't the predictions come true?

I'm not sure, but if I had to guess I'd say (1) the Fed is still worried about inflation, and the fact is that inflation hasn't gone away -- the latest Consumer Price Index reading shows an inflation rate of 4.8%. (2) The Fed is worried about the dollar, and rightly so.

Shown at the top of page 6 are two point & figure charts from *Chartcraft*. I usually use the T-bond and the Muni bond contract to confirm each other. So far, although the T-bonds have been flirting with their highs, the Muni contract is lagging rather noticeably. A breakout by the T-bonds with the Muni contract refusing to follow would make me suspicious. At any rate, the picture in the money market is both confusing and fascinating. And nothing's been resolved yet.


TREASURY BONDS (CBT) MARCH 1990
T-BONDS- Charts showing very broad tops with next move expected to be down at least to long term support line. A fall through that could see big downside action.



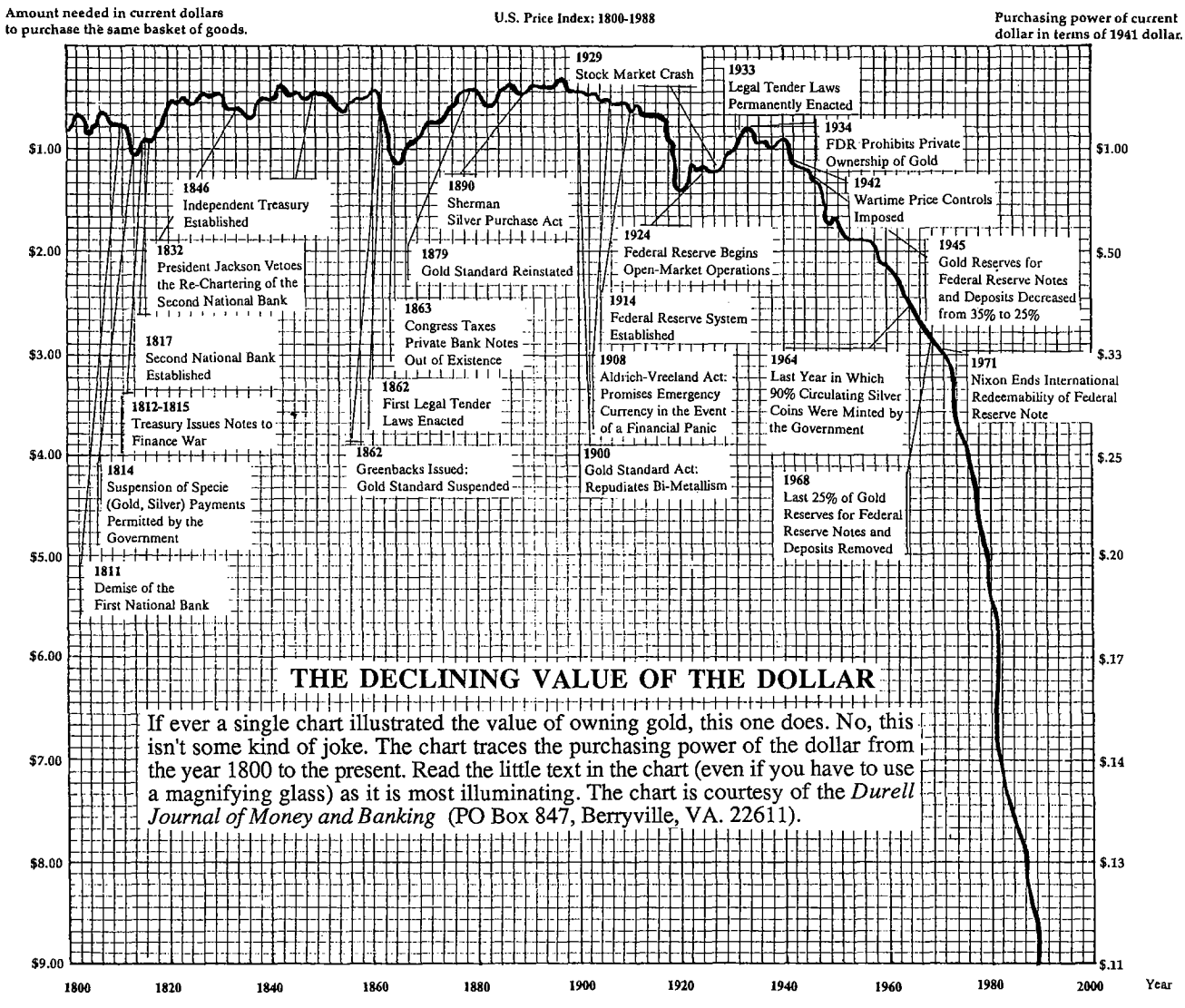
NEXT MAILING: Jan. 10, 1990

surging totals of world debts and liabilities will exert continuing upward pressure on the price of gold.

I don't like to keep repeating myself in Letter after Letter. So suffice it to say that I feel all subscribers should be stockpiling gold items -- gold coins, gold stocks, gold no-load funds.

Everything appears to be walking a tightrope today. Fed policy, the stock market, the US economy -- so why not gold? What I'm saying is that you're going to need patience with gold here. But really, what's the hurry? IBM and GM may go broke, your home may be eaten by termites, your boss may retire and close down his business, but gold will always be around and gold will always be money. So start collecting it. The timing (within reason and with a bit of patience) appears to be right.

GOLD: Worried about increasing gold production? Consider this: World gold production this year will be roughly 1,600 tons. At an average price of $414 an ounce, this is about $21.2 billion dollars worth of gold. In the single month of October alone, the US federal deficit was $26.09 billion. Total world gold production may go up slightly this year, up maybe 2%. But the increase in the world's debts and deficits dwarfs any increase in the value of gold. The Whoops, we've got a few lines left. And with these few lines I want to wish all my loyal subscribers (yes, and even those thousands who read these Letters via bootlegged copies -- you know who you are) a very **happy and joyous New Year.** It's going to be exciting in 1990 -- I can feel it in my bones. And oh yes, in the next issue I'm going to include an eye-popping piece on gold and the compounding of the US debt.


Amount needed in current dollars to purchase the same basket of goods.
U.S. Price Index: 1800-1988
Purchasing power of current dollar in terms of 1941 dollar.
$1.00
$2.00
$3.00
$4.00
$5.00
$6.00
$7.00
$8.00
$9.00
$1.00
$.50
$.33
$.25
$.20
$.17
$.14
$.13
$.11
1800
1820
1840
1860
1880
1900
1920
1940
1960
1980
2000
Year
1811 Demise of the First National Bank
1812-1815 Treasury Issues Notes to Finance War
1814 Suspension of Specie (Gold, Silver) Payments Permitted by the Government
1817 Second National Bank Established
1832 President Jackson Vetoes the Re-Chartering of the Second National Bank
1846 Independent Treasury Established
1862 First Legal Tender Laws Enacted
1862 Greenbacks Issued: Gold Standard Suspended
1863 Congress Taxes Private Bank Notes Out of Existence
1879 Gold Standard Reinstated
1890 Sherman Silver Purchase Act
1900 Gold Standard Act: Repudiates Bi-Metallism
1908 Aldrich-Vreeland Act: Promises Emergency Currency in the Event of a Financial Panic
1914 Federal Reserve System Established
1924 Federal Reserve Begins Open-Market Operations
1929 Stock Market Crash
1933 Legal Tender Laws Permanently Enacted
1934 FDR Prohibits Private Ownership of Gold
1942 Wartime Price Controls Imposed
1945 Gold Reserves for Federal Reserve Notes and Deposits Decreased from 35% to 25%
1964 Last Year in Which 90% Circulating Silver Coins Were Minted by the Government
1968 Last 25% of Gold Reserves for Federal Reserve Notes and Deposits Removed
1971 Nixon Ends International Redeemability of Federal Reserve Note
THE DECLINING VALUE OF THE DOLLAR
If ever a single chart illustrated the value of owning gold, this one does. No, this isn't some kind of joke. The chart traces the purchasing power of the dollar from the year 1800 to the present. Read the little text in the chart (even if you have to use a magnifying glass) as it is most illuminating. The chart is courtesy of the Durell Journal of Money and Banking (PO Box 847, Berryville, VA. 22611).